Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

199908060

Person to Contact:

Telephone Number:

Refer Reply to: OP:E:EP:T:3

Date:

DEC 2 1998

LEGEND:

Taxpayer A:

Taxpayer B:

Taxpayer C:

Taxpayer D:

Company E:

State F:

Plan X:

Plan Y:

Dear Ms. :

This is in response to the , letter written on your behalf by your authorized representative, as supplemented and revised by correspondence dated , and in which you request several letter rulings under sections 401(a)(9) and 402(d) of the Internal Revenue Code. The following facts and representations support your ruling requests.

Company E is the sponsor and administrator of Plan Y. Company E also sponsored and administered Plan X, a money purchase plan, prior to its merger into Plan Y.

Company E established Plan X effective July 1, 1971, and Company E established Plan Y effective July 1, 1967. Each Plan either has or had a June 30 plan year end. Taxpayer A was a shareholder, director, officer and employee of Company E for a number of years until his , death. Taxpayer A was years of age at his death. Taxpayer A participated in Plan Y from July 1, 1967 until his death, and he participated in Plan X from July 1, 1971 until his death.

At the time of his death, Taxpayer A's individual employer contribution account balance in Plan X was $469,467.12, and his individual account balance in Plan Y was $489,922.33. At the time oi his death, Taxpayer A's individual after-tax voluntary employee contribution account balance in Plan Y was $295,898.27 which consisted of $161,077.94 accumulated after-tax voluntary employee contributions and $134,820.33 accumulated earnings thereon. Taxpayer A had not received a distribution of any of his benefits from either Plan X or Plan Y prior to his death.

Taxpayer A was survived by his wife, Taxpayer B. All of the Taxpayer A's benefits under Plans X and Y were earned during Taxpayer A's marriage to Taxpayer B while they resided in State F, a community property state. Taxpayer B attained age 70 1/2 on December 19, 1994. Taxpayers C and D are the sons of Taxpayers A and B.

As stated above, Plan X was merged into Plan Y on November 30, 1993. A separate and distinct individual account is maintained under Plan Y to hold Taxpayer A's Plan X account balance which was transferred to Plan Y. Your authorized representative asserts that Plan Y was amended to provide that said separate and distinct account would be credited with its prorated share of the future investment earnings in Plan Y, that such separate account would not be credited with any future allocation of employer contributions or forfeitures under Plan Y, and that the beneficiary designation under Plan X of a Plan X participant who had died prior to Plan X's merger into Plan Y would continue to govern the future disposition of the separate and distinct account established under Plan Y for such deceased participant's transferred Plan X benefits.

As of June 30, 1997, the balance of Taxpayer A's Plan Y account which holds his Plan X benefits was $1,564,445.52; as of June 30, 1997, the balance of Taxpayer A's individual employer contribution account in Plan Y was $1,593,082.58; and as of June 30, 1997, the balance of Taxpayer A's individual after-tax voluntary employee contribution account in Plan Y was $1,078,024.15. The total held in the above accounts was $4,235,552.25.

Taxpayer A's beneficiary designations with respect to Plans X and Y name Taxpayer B as the beneficiary during her lifetime. At the death of Taxpayer B, the remaining benefits are to be distributed to Taxpayers C and D. Taxpayer B signed and agreed to both beneficiary designations.

The beneficiary designations, which are dated October 20, 1978, provide as follows:

> So long as my wife, Taxpayer B, herein referred to as "my wife", shall live, I direct that the Trustee of this Plan shall continue to hold all death benefits due to me or my designated beneficiary, and if my wife's own income, when consumed, is not sufficient to provide for her support, maintenance, care and health during her life in a reasonable standard of living (not to exceed that which we maintain at the time of my death), then the Trustee of this Plan shall periodically distribute to my wife as much of my death benefits under this Plan as shall be necessary to provide for her support, maintenance, care and health in such standard of living. Upon the death of my wife any and all amounts which she or her estate might have in any then remaining undistributed benefits due to me or my designated beneficiary under this Plan shall terminate, and all such then remaining undistributed benefits shall thereafter be payable equally to my two sons, Taxpayer C and Taxpayer D.

Taxpayer B's authorized representative has asserted that each of the above-referenced beneficiary designations creates a trust under the laws of State F. Furthermore, the representative has asserted that each trust became irrevocable at the death of Taxpayer A. The authorized representative has also asserted that copies of the beneficiary designations in which the trusts were created were delivered to the administrator(s) of Plans X and Y. Finally, the authorized representative has asserted that the duties of the trustee(s) of each trust include holding the trust assets during Taxpayer B's lifetime and making trust distributions to her as needed for her support in accordance with the language of the beneficiary designations.

Section 9.01 of Plan X and of Plan Y provides that benefits under the plan may be paid in any or more of the following ways: (1) in a lump sum; (2) in equal, periodic payments over a term certain made from the trust directly to the member and/or the member's beneficiary and the payment is not conditioned upon the survival of the member or beneficiary; or (3) by any combination of the above.

Section 9.03(6) of Plan X and of Plan Y provides that the life expectancy of a surviving spouse may be recalculated annually.

Section 9.03(5)(b) of Plan X and of Plan Y provides that, in the case of a plan participant who dies prior to distribution of his interest commencing, distributions of the participant's entire interest will be distributed no later than 5 years after the participant's death except that a designated beneficiary may elect to receive distributions over her life expectancy commencing no later than one year after the participant's death.

Since Taxpayer A's death, Taxpayer B has had sufficient income of her own to provide for her support, maintenance, care and health in a reasonable standard of living. Thus, she has received no distributions under either Plan X (merged into Plan Y) or Plan Y attributable to Taxpayer A's benefits under either plan. It has been asserted on behalf of Taxpayer B that she will probably not need any of Taxpayer A's benefits under either Plan X or Plan Y during her lifetime to provide for her support, maintenance, care and health in a reasonable standard of living due to her other income.

Additionally, no distribution from either Plan X or Plan Y of any amounts standing to Taxpayer A's credit in either plan as of his date of death have been made to either trust created under Taxpayer A's October 20, 1978 beneficiary designations with respect to the plans since his death.

Taxpayer B has been a shareholder, director, officer and employee of Company E for a number of years. She has been a participant in Plan Y since July 1, 1967, and participated in Plan X from July 1, 1971 until its November 30, 1993 merger with Plan Y. Taxpayer B has begun to receive distributions of her Plan Y benefits .

Taxpayer A would have attained age 70 1/2 on May 22, 1989, if he had lived until that date.

Taxpayer B intends to assign her interests in both of the separate trusts, including her interest in Taxpayer A's Plan Y account balance, which includes his Plan X benefits held in a separate account, to Taxpayers C and D. In conjunction with said assignment, Taxpayer B's interest in Taxpayer A's Plan Y account balance, including his Plan X benefits held in a separate account, will be distributed to the trust(s) created under Taxpayer A's October 20, 1978 beneficiary designations in the form of a single sum distribution. The trusts will then be terminated and the trustees thereof will distribute the plan benefits to

Taxpayers C and D. Said distribution is expected to be made no later than December 31, 1998.

Based on the above facts and representations, you request the following letter rulings:

(1) Taxpayer A's beneficiary designation, dated October 20, 1978, for his benefits under Plan X is a designation under section 242(b)(2) of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA);

(2) Assuming the Service rules adversely with respect to ruling request (1), above, then

a. The minimum required distributions to the separate trust created under Taxpayer A's beneficiary designation dated October 20, 1978, for his benefits under Plan X prior to its merger into Plan Y on November 30, 1973, and for the separate account maintained under Plan Y for his benefits under Plan X that were transferred to Plan Y are determined as follows:

(i) under Code section 401(a)(9)(B)(iv);

(ii) the required beginning date was December 31, 1989;

(iii) the distribution period to be used in determining the amount of minimum required distribution for each calendar year is the life expectancy of Taxpayer B for her attained age as of her birthday in the respective distribution calendar year;

(iv) the life expectancy of Taxpayer B is to be recalculated annually; and

(v) the November 30, 1993 merger of Plan X into Plan Y does not change the method of the calculation of the minimum required distributions for the separate account maintained under Plan Y for Taxpayer A's benefits under Plan X that were transferred to Plan Y.

(3) Taxpayer A's beneficiary designation, dated October 20, 1978, for his benefits under Plan Y is a designation under section 242(b)(2) of TEFRA;

(4) Assuming the Service rules adversely with respect to ruling request (3), above, then

a. The minimum required distributions to the separate trust created under Taxpayer A's beneficiary designation dated October 20, 1978, for his benefits under Plan Y are determined as follows:

(i) under Code section 401(a)(9)(B)(iv);

(ii) the required beginning date was December 31, 1989;

(iii) the distribution period to be used in determining the amount of minimum required distribution for each calendar year is the life expectancy of Taxpayer B for her attained age as of her birthday in the respective distribution calendar year;

(iv) the life expectancy of Taxpayer B is to be recalculated annually; and

(v) the November 30, 1993 merger of Plan X into Plan Y does not change the method of the calculation of the minimum required distributions for the separate account maintained under Plan Y for Taxpayer A's benefits under Plan Y.

(5) A distribution by Plan Y to the separate trust created under Taxpayer A's October 20, 1978, beneficiary designation of the balance to the credit of the separate account maintained under Plan Y for Taxpayer A's benefits under Plan X that were transferred to Plan Y on November 30, 1993, and a distribution at the same time by Plan Y to the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation of the balance to the credit of the separate account maintained under Plan Y for Taxpayer A's benefits under Plan Y will:

(a) qualify to be treated as a lump sum distribution under Code section 402(d) as in effect for taxable years beginning before January 1, 2000;

(b) result in the gross distribution to the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation of his benefits under Plan X constituting the taxable amount to the trust:

(c) result in the gross distribution to the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation of his benefits under Plan Y, less the amount of the accumulated after-tax voluntary contributions which were made by Taxpayer A to Plan Y, constituting the taxable amount to the trust: and

(d) result in 43.52% of the taxable amount of the distributions to each of the separate trusts created under Taxpayer A's October 20, 1978 beneficiary designations being treated as the capital gains portion of the distributions and 56.48% being treated as the ordinary income portion.

(6) Since the distributions are being made by Plan Y to multiple trusts, the election under Code section 402(d)(4)(B) to treat the distribution(s) as a lump sum distribution must be made by the personal representative of Taxpayer A's estate;

(7) 43.52% of the taxable amount is eligible to be taxed at the 20% capital gains tax rate under paragraph (3) of section 1122(h) of the Tax Reform Act of 1986 (TRA'86), and the remaining 56.48% of the taxable amount is eligible to be taxed under either the 5-year averaging method of Code section 402(d) as in effect for taxable years beginning before January 1, 2000, or the 10-year averaging method of taxation under paragraph (5) of section 1122(h) of TRA'86;

(8) The tax under paragraph (3) of section 1122(h) of TRA'86 shall be computed as if such distribution(s) were made to a single distributee, but the liability for such tax shall be apportioned among Taxpayers C and D according to the taxable amount received by each taxpayer;

(9) The tax under the 5-year averaging method of taxation of Code section 402(d) as in effect for taxable years beginning before January 1, 2000, or the tax under the 10-year averaging method of taxation described in section 1122(h) of TRA'86, shall be computed as if such distribution(s) were made to a single trust, but the

liability for such tax shall be apportioned among the two trusts according to the taxable amounts received by each trust;

(10) If the election to be taxed at the 20% capital gains rate under paragraph (3) of section 1122(h) of TRA'86 is made, then the capital gains portion will not be included in determining the distributable net income of each trust;

(11) If each trust distributes equally to Taxpayer C and Taxpayer D the entire distribution it receives from Plan Y (including amounts transferred from Plan X) within the same taxable year of the trust in which it receives the distribution from Plan Y, then with respect to the capital gains portion of the distribution:

(a) the trust will be allowed a deduction for the amount of the capital gains portion under Code section 661(a) and, as a result, will not pay tax with respect to said portion;

(b) the capital gains portion will be taxed equally to Taxpayer C and Taxpayer D under Code section 662; and

(c) under Code section 662(b), the character of the capital gains portion will be passed through to Taxpayers C and D and they will be eligible to be taxed on said capital gains portion at the 20 percent capital gains rate pursuant to paragraph 3 of section 1122(h) of TRA'86.

(12) If the election under paragraph (5) of section 1122(h) of TRA'86 to be taxed under the 10-year averaging method of taxation or the election to be taxed under the 5-year averaging method of taxation described in Code section 402(d) is made, then the ordinary income portion will not be included in determining the distributable net income of each trust;

(13) If each trust distributes equally to Taxpayer C and Taxpayer D the entire distribution it receives from Plan Y (including amounts transferred from Plan X) within the same taxable year of the trust in which it receives the distribution from Plan Y, then with respect to the ordinary income portion of the distribution:

(a) the trust will be allowed a deduction for the amount of the ordinary income portion under Code section 661(a) and, as a result, will not pay tax with respect to said portion;

(b) the ordinary income portion will be taxed equally to Taxpayer C and Taxpayer D under Code section 662; and

(c) under Code section 662(b), the character of the ordinary income portion will be passed through to Taxpayers C and D and they will be eligible to be taxed on said ordinary income portion under either the special 5-year averaging method under Code section 402(d) as in effect for taxable years beginning before January 1, 2000, or the special 10-year averaging method under paragraph 5 of section 1122(h) of TRA'86.

(14) The assignment and transfer by Taxpayer B equally to Taxpayers C and D of any and all interest that she has in the separate trusts created under Taxpayer A's October 20, 1978 beneficiary designations does not affect the Service's answers to ruling requests (5) through (13) above;

(15) The termination and full distribution equally to Taxpayers C and D of the entire trust assets of the separate trusts created under Taxpayer A's October 20, 1978 beneficiary designations immediately after such trusts receive the distribution from Plan Y does not affect the Service's answers to ruling requests (5) through (13) above;

(16) Each of the following will not be considered an assignment or alienation of benefits prohibited by Code section 401(a)(13);

a. A distribution by Plan Y to the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation of his benefits held in the separate account in Plan Y which account holds Taxpayer A's Plan X benefits transferred to Plan Y on November 30, 1993;

b. the assignment and transfer by Taxpayer B equally to Taxpayers C and D of any and all of her interest in the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation to receive his benefits under Plan X; and

c. the termination and full distribution equally to Taxpayers C and D of the entire trust assets of the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation to hold his benefits under Plan X immediately after such trust receives the distribution described in 16(a) above.

(17) Each of the following will not be considered an assignment or alienation of benefits prohibited by Code section 401(a)(13);

a. A distribution by Plan Y to the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation of his benefits held in the separate account(s) in Plan Y which accounts hold Taxpayer A's Plan Y benefits;

b. the assignment and transfer by Taxpayer B equally to Taxpayers C and D of any and all of her interest in the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation to receive his benefits under Plan Y; and

c. the termination and full distribution equally to Taxpayers C and D of the entire trust assets of the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation to receive his benefits under Plan Y immediately after such trust receives the distribution described in (17)a above.

(18) When Taxpayer B assigns and transfers equally to Taxpayer C and Taxpayer D all of her interest in each of the separate trusts created under Taxpayer A's beneficiary designations, then with respect to such transferred portion(s) of said trusts:

a. Taxpayer B is considered to have made a transfer and gift as of the date of such assignment and transfer of the value of her contingent support interest in each separate trust;

b. the value of her contingent support interest is not susceptible of being valued on the basis of actuarial principles set forth in Regulation section 25.2512-5, and is to be valued in accordance with the principles set forth in Regulation section 25.2512-1 as the price at which such contingent support interest would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts;

c. the following would be among the relevant facts that would be taken into consideration by a willing buyer and a willing seller having reasonable knowledge of relevant facts:

(i) Since January 18, 1983, Taxpayer B's own income has always been sufficient to provide for her support, maintenance, care and health in the reasonable standard of living specified in Taxpayer A's beneficiary designations;

(ii) Taxpayer B's current income is more than sufficient to provide at this time for her support, maintenance, care and health in the reasonable standard of living specified in Taxpayer A's beneficiary designations; and

(iii) it is projected that Taxpayer B's income will always be more than sufficient to provide for her support, maintenance, care and health in the reasonable standard of living specified in Taxpayer A's beneficiary designations.

With respect to the above referenced first and third ruling requests, section 401(a) of the Internal Revenue Code sets forth the qualification requirements which must be met by a trust which forms a part of a pension, profit-sharing, or stock bonus plan.

A pension plan within the meaning of Code section 401(a) is a plan established and maintained by an employer primarily to provide systemically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement. A pension plan may provide for the payment of incidental death benefits through insurance or otherwise. (See section 1.401-1(b)(1)(i) of the Income Tax Regulations.

Section 1.401-1(b)(1)(ii) of the regulations defines a profit-sharing plan as a plan established and maintained by an employer to provide for the participation in his profits, by his employees or their beneficiaries, based on a definite predetermined formula for allocating the contributions made to the plan among the participants and for distributing the funds accumulated under the plan after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event, such as layoff, illness, disability, retirement, death, or severance of employment.

Revenue Ruling 56-656, 1956-2 C.B. 280, states that the requirements in the regulations that the funds be distributed after a fixed number of years, or the attainment of a stated age, was intended to mean "distributed to the employee". It further states that payments to others should be merely incidental as, for example, in a joint and survivor annuity contract, or where an unused balance in the account of the employee is paid to a beneficiary upon the death of the employee. Rev. Rul. 56-656 also holds that an employees' plan that permits a participant to irrevocably elect, prior to retirement, to have all or a part of his interest in the plan, which would otherwise become available to him during his lifetime, paid only to his designated beneficiary after his death will fail to meet the requirements of Code section 401(a).

Rev. Rul. 72-240, 1972-1 C.B. 108, states that the provisions in a plan permitting distribution of a participant's interest over the lives of the employee and his spouse, will not prevent the plan from qualifying under Code section 401(a), even though the employee's beneficiary is someone other than his spouse.

Rev. Rul. 72-241, 1972-1 C.B. 108, states that any settlement option (other than an option contemplated in Rev. Rul. 72-240) will meet the requirements of section 1.401-1(b)(1)(i) of the regulations that benefits payable to the beneficiary of an employee must be incidental to the primary purpose of distributing accumulated funds to the employee, if it contains certain provisions whereby the present value of the payments to be made to the participant is more than 50% of the present value of the total payments to be made to the participant and his beneficiaries.

Rev. Rul. 73-445, 1973-2 C.B. 127, states that a profit-sharing plan that permits a participant to elect a settlement option providing payments to him of an unlimited number of equal monthly installments of not less than $100 starting at age 65, and in the event of his death to his beneficiary or beneficiaries, until the entire trust interest is exhausted, does not meet the requirements of section 1.401-1(b)(1)(i) of the regulations that benefits payable to the beneficiary of an employee must be incidental to the primary purpose of distributing accumulated funds to the employee.

Rev. Rul. 74-325, 1974-2 C.B. 127, states that an employee's pension or profit-sharing plan that permits payments of an annuity to the employee for life and thereafter to a designated beneficiary, not necessarily his spouse, for life regardless of age and contains no assurance that more than 50% of the total value of his benefits will inure to the participant, fails to meet the requirements of section 1.401-1(b)(1)(i) of the regulations.

Rev. Rul. 74-359, 1974-2 C.B. 129, states that a profit-sharing plan permitting a retired participant to receive his distribution in a lump sum, in installments, or as an annuity contract and requiring that the mode selected result in the participant, his spouse as survivor, or both receiving at least 50% of the anticipated total distribution, with other beneficiaries entitled to share in any remaining balance, will not qualify under Code section 401(a).

Section 401(a)(14) of the Code provides that a trust shall not constitute a qualified trust under the section unless that plan of which the trust is a part provides that, unless the participant otherwise elects, the payment of benefits under the plan to the participant will begin not later than the 60th day after the latest of the close of the plan year in which:

(A) the date on which the participant attains the earlier of age 65 or the normal retirement age specified under the plan,

(B) occurs the 10th anniversary of the year in which the participant commenced participation in the plan, or

(C) the participant terminates his service with the employer.

Section 401(a)(9) of the Code was amended by section 242 of the Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. 97-248) (1982-2 C.B. 462) (TEFRA), and was further amended by section 521 of the Tax Reform Act of 1984 (Pub. L. 98-369) (TRA'84) and by sections 1121 and 1852 of the Tax Reform Act of 1986 (Pub. L. 99-514) (TRA'86). Section

242(b)(2) of TEFRA provided a transition rule that was not affected by the later amendments to section 401(a)(9).

Section 242(b)(1) of TEFRA provides that amendments to section 401(a)(9) of the Code made by section 242(a) of TEFRA shall apply to plan years beginning after December 31, 1983. However, section 242(b) of TEFRA provides the following transitional rule:

> TRANSITION RULE: A trust forming part of a plan shall not be disqualified under paragraph (9) of section 401(a) of the Internal Revenue Code of 1954, as amended by subsection (a) by reason of distributions under a designation (before January 1, 1984) by any employee of a method of distribution:
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> (A) which does not meet the requirements of such paragraph (9), but
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> (B) which would not have disqualified such trust under paragraph (9) of section 401(a) of such Code as in effect before the amendment made by subsection (a).

Notice 83-23, 1983-2 C.B. 418, provides guidance with respect to distributions that may be made by a qualified plan under the transition rule of section 242(b)(2) of TEFRA. In order for the transitional rule in section 242(b)(2) of TEFRA to apply to a distribution from a qualified trust, the distribution must be made in accordance with the following requirements as set forth in Notice 83-23:

(1) The distribution by the trust is one which would not have disqualified the trust under section 401(a)(9) of the Code as in effect immediately prior to the effective date of 242(a) of TEFRA.

(2) The distribution is in accordance with a method of distribution designated by the employee whose interest in the trust is being distributed or, if the employee is deceased, by a beneficiary of such employee.

(3) Such designation is in writing, is signed by the employee or the beneficiary, and is made before January 1, 1984.

(4) The employee whose interest in the trust is being distributed has accrued a benefit under the plan of which the trust is a part as of December 31, 1983.

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(5) The method of distribution designated by the employee specifies the following:

(a) the form of the distribution (lump sum, level dollar annuity, formula annuity, specified percentage payment per year, etc.),

(b) the time at which distributions will commence (upon retirement, at a stated age, etc.),

(c) the period over which distributions will be made (over the employee's life expectancy, over a stated number of years, etc.), and

(d) in the case of any distribution upon the employee's death, the beneficiaries of the employee listed in order of priority.

The designation must, in and of itself, provide sufficient information to fix the time, and the formula for the definite determination of plan payments. The designation must be complete and not allow further choice.

A distribution upon death will not be covered by this transitional rule unless the information in the designation contains the information described in items (5)(a)-(d) above with respect to the distributions to be made upon the death of the employee.

If a designation made in accordance with the above requirements is revoked by an employee or, if the employee is deceased, by his beneficiary, subsequent to December 31, 1983, the transitional rule in section 242(b)(2) of TEFRA will not apply to the distribution and the employee's interest must be distributed in accordance with section 401(a)(9) as amended by section 242(a) of TEFRA. Any change in the designation will be considered to be a revocation of the designation. However, the mere substitution or addition of another beneficiary (one not named in the designation) under the designation will not be considered to be a revocation of the designation, so long as such substitution or addition does not alter the period over which distributions are to be made under the designation, directly or indirectly (for example, by altering the relevant measuring life).

We believe that the beneficiary designation made by Taxpayer A does not satisfy the requirements of section

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242(b)(2) of TEFRA and Notice 83-23 for the following reasons.

Initially, the method of distribution provides for payment only to a designated beneficiary after the death of the participant. We believe that section 242(b)(2) elections pertain to payments of benefits to the participant and a designated beneficiary. A designation solely to the designated beneficiary without payment to the participant is not contemplated by section 242(b)(2).

Second, the designation made by Taxpayer A would have disqualified the plan(s) under the law as in effect prior to the enactment of TEFRA for the following reasons. The first reason for disqualification is that the method of distribution is in conflict with section 9.01 of the plan(s) which provides that benefit payments must be in the form of a lump sum or in equal periodic payments. The second reason for disqualification is that a method of payment that consists of only a distribution after the death of the surviving spouse would fail to provide for incidental death benefits. Under the facts in this case, no distribution would be expected until after the death of both the participant, Taxpayer A, and his spouse, Taxpayer B. This distribution would be other than a distribution of investment income as described in Rev. Rul. 56-656.

The third reason that Taxpayer A's designation is not a valid section 242(b)(2) election is that it fails to satisfy the requirements for a method of distribution in items (5)(b) and (c) of Notice 83-23. The reasons for this are as follows:

(a) The time when the distributions are to commence (sometime after the death of Taxpayer A) is not specified. Again, payments are only to commence when Taxpayer B's other income is insufficient to provide for her "support, maintenance, care and health in such standard of living".

(b) The time period over which the benefits are to be paid is not specified. The designations only provide that the payments will be made "as necessary, until Taxpayer B's death, upon which time the balance of the accounts will be paid equally to the two sons".

With respect to (b), however, we note that the order of priority is given (benefits will be paid initially to

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Taxpayer B and, upon her death, the balance will be distributed to her two sons).

Additionally, the amount of and time when distributions can be made are at the discretion of Taxpayer B and the plan administrator. Their judgment determines when and if distributions are to be made. That is, it is within their discretion to determine when Taxpayer B's income falls below that needed to provide for her "support, maintenance, care and health in such standard of living".

Therefore, with respect to Taxpayer A's first and third ruling requests, we conclude as follows:

(1) With respect to the election made by Taxpayer A with respect to Plan X, the requirements set forth in section 242(b)(2) of TEFRA and Notice 83-23 are not satisfied. Thus, Taxpayer A's interest in Plan X remaining at his death must be distributed in accordance with section 401(a)(9) without regard to Taxpayer A's purported section 242(b)(2) election.

(3) With respect to the election made by Taxpayer A with respect to Plan Y, the requirements set forth in section 242(b)(2) of TEFRA and Notice 83-23 are not satisfied. Thus, Taxpayer A's interest in Plan Y remaining at his death must be distributed in accordance with section 401(a)(9) without regard to Taxpayer A's purported section 242(b)(2) election.

With respect to your second, and fourth ruling requests, section 401(a)(9)(A) of the Code provides that a trust shall not constitute a qualified trust under this subsection unless the plan provides that the entire interest of each employee-

(i) will be distributed to such employee not later than the required beginning date, or

(ii) will be distributed, beginning not later than the required beginning date, in accordance with regulations, over the life of such employee or over the lives of such employee and a designated beneficiary (or over a period not extending beyond the life expectancy of such employee or the life expectancy of such employee and a designated beneficiary).

Section 401(a)(9)(C) of the Code provides that, for purposes of this paragraph, the term "required beginning date" means April 1 of the calendar year following the calendar year in which the employee attains age 70 1/2.

Section 401(a)(9)(D) of the Code provides that, for purposes of this paragraph, the life expectancy of an employee and the employee's spouse (other than in the case of a life annuity) may be redetermined but not more frequently than annually.

Section 1.401(a)(9)-1 of the Proposed Income Tax Regulations, Question and Answer E-7(c), provides, generally, that a plan may adopt a provision that permits an employee (or spouse) to elect to recalculate life his/her life expectancy. A plan may also contain a provision which specifies whether or not life expectancy in the event that an employee (or spouse) fails to make such an election. Absent such a provision, the life expectancy of an employee (or his spouse) will be recalculated absent an election not to recalculate.

Section 401(a)(9)(B)(ii) of the Code provides that a trust shall not constitute a qualified trust under this section unless the plan provides that, if an employee dies before the distribution of the employee's interest has begun in accordance with subparagraph (A)(ii), the entire interest of the employee will be distributed within 5 years after the death of such employee.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A C-2, provides that, in order to satisfy the five-year rule in section 401(a)(9)(B)(ii), the employee's entire interest must be distributed as of December 31 of the calendar year which contains the fifth anniversary of the date of the employee's death.

Section 401(a)(9)(B)(iii) of the Code provides an exception to the above referenced 5-year rule. Under the exception, any portion of an employee's interest payable to a designated beneficiary which is to be distributed (in accordance with regulations) over the life of such designated beneficiary (or over a period not extending beyond the life expectancy of such beneficiary) may be so distributed beginning not later than 1 year after the date of the employee's death or such later date as the Secretary may by regulations prescribe.

Section 401(a)(9)(B)(iv) of the Code provides, in relevant part, that if the designated beneficiary referred to in clause (iii)(I) is the surviving spouse of the employee-(I) the date on which the distributions are required to begin under clause (iii)(III) shall not be earlier than the date on which the employee would have turned age 70 1/2.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A D-4, provides, in relevant part, that for purposes of calculating the distribution period described in section 401(a)(9)(B)(iii) or (iv), the designated beneficiary will be determined as of the employee's date of death. If, as of the date of the employee's death, there is no designated beneficiary under the plan with respect to that employee, distribution must be made in accordance with the five-year rule in section 401(a)(9)(B)(ii).

Section 1.401(a)(9)-1 of the proposed regulations, Q&A C-3(a) provides that, in order to satisfy the exception to the five-year rule for nonspouse beneficiaries, distributions must commence on or before December 31 of the calendar year immediately following the calendar year in which the employee died. This rule also applies to the distribution of the entire remaining benefit if, as of the employee's date of death, an individual is designated as a beneficiary in addition to the employee's surviving spouse.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A C-3(b), provides that in order to satisfy the rule in section 401(a)(9)(B)(iii) and (iv), if the designated beneficiary is the employee's surviving spouse, distributions must commence on or before the later of (1) December 31 of the calendar year immediately following the calendar year in which the employee dies and (2) December 31 of the calendar year in which the employee would have attained age 70 1/2.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A D-2A, provides that only individuals may be designated beneficiaries for purposes of section 401(a)(9). A person who is not an individual, such as the employee's estate, may not be a designated beneficiary. However, Q&A D-5 of section 1.401(a)(9)-1 provides that beneficiaries of a trust with respect to the trust's interest in an employee's benefit may be treated as designated beneficiaries if the following requirements are met.

(1) The trust is valid under state law or would be but for the fact that there is no corpus.

(2) The trust is irrevocable or the trust contains language to the effect it becomes irrevocable upon the death of the employee.

(3) The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's benefit are identifiable from the trust instrument.

(4) The documentation described in D-7 of this section has been provided to the plan administrator.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A D-6, provides that in the case in which a trust is named as the beneficiary of an employee, all beneficiaries of the trust with respect to the trust's interest in the employee's benefit are treated as designated beneficiaries of the employee under the plan for purposes of determining the distribution period under section 401(a)(9)(B)(iii) and (iv) if the requirements in paragraph (a) of D-5 (above) are satisfied as of the date of the employee's death, or, in the case of the documentation described in D-7 of this section, by the end of the ninth month beginning after the employee's death.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A D-7 provides, in general, that the plan administrator be provided with either a list of all trust beneficiaries as of the date of death or with a copy of the trust document for the trust which is named as beneficiary of the plan as of the employee's date of death.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A E-5(a)(1), provides, in pertinent part, that if more than one individual is designated as a beneficiary with respect to an employee as of the applicable date for determining the designated beneficiary, the designated beneficiary with the shortest life expectancy will be the designated beneficiary for purposes of determining the distribution period. The date for determining the designated beneficiary (under D-3 or D-4, whichever is applicable) is the applicable date.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A E-5(b), states that except as provided in paragraph (e)(1), if a beneficiary's entitlement to an employee's benefit is contingent on an event other than the employee's death (e.g. the death of another beneficiary), such contingent beneficiary is considered to be a designated beneficiary for purposes of determining which designated beneficiary has the shortest life expectancy under paragraph (a).

Section 1.401(a)(9)-1 of the proposed regulations, Q&A E-5(e)(1), provides that if a beneficiary's entitlement to an employee's benefit is contingent on the death of a prior beneficiary, such contingent beneficiary will not be considered a beneficiary for purposes of determining who is the designated beneficiary with the shortest life expectancy or whether a beneficiary who is not an individual is a beneficiary.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A E-5(f), provides that if the plan provides (or allows the employee to specify) that, after the employee's death, any person or persons have the discretion to change the beneficiaries of the employee, then, for purposes of determining the distribution period for both distributions before and after the employee's death, the employee will be treated as not having designated a beneficiary.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A A-2, provides that the distribution rules of Code section 401(a)(9) apply to all account balances and benefits in existence on or after January 1, 1985, even if the employee has retired or died.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A I-7, provides, in relevant part, that if an employee died prior to January 1, 1986, and distributions are to be made over the life expectancy of a designated beneficiary in accordance with section 401(a)(9)(B)(iii) and (iv), the first distribution calendar year for which a minimum distribution is required is the later of (1) the calendar year which contains the required commencement date determined under C-3(a) or (b), whichever is applicable, or (2) calendar year 1985. Any minimum distribution required for calendar year 1985 must have been made by December 31, 1987.

Section 1.401(a)(9)-1 of the proposed regulations, Q&A I-13, provides, in relevant part, that if an employee died prior to January 1, 1985, and distribution is to be made in accordance with the five-year rule contained in section 401(a)(9)(B)(ii), the employee's entire interest must be distributed as of the later of (a) December 31 of the calendar year which contains the fifth anniversary of the employee's death or (b) December 31, 1987.

With respect to your second and fourth ruling requests, the beneficiary (ies) of Plans X (merged into Plan Y without affecting the identity of its beneficiary) and Y are the trusts created under the previously referenced October 20, 1978 beneficiary designations. Taxpayer B is entitled to receive income, and principal, from said trusts but her right to income and principal is subject to the standard described therein. Taxpayers C and D are entitled to receive any amounts remaining at Taxpayer B's death.

Although distributions from Plans X and Y were required to have been made in accordance with the rules of Code section 401(a)(9), Taxpayer B was not entitled to receive all Code section 401(a)(9) required distributions. Thus, Plans X and Y could have distributed to the trusts created pursuant to the October 20, 1978 beneficiary designations amounts in excess of the amounts which the trusts were required to distribute to Taxpayer B.

Since amounts distributed from Plans X and Y could have remained in the trusts created pursuant to the October 20, 1978 beneficiary designations during Taxpayer B's lifetime, Taxpayers C and D must be treated as designated beneficiaries for purposes of determining the Code section 401(a)(9) payout period. Thus, Taxpayer B is not the sole designated beneficiary of Taxpayer A's interests in Plans X and Y, and the rule in section 1.401(a)(9)-1 of the proposed regulations, Q&A C-3(b), is inapplicable in this case. Therefore, we must determine if the rule in section 1.401(a)(9)-1 of the proposed regulations, Q&A C-3(a) applies.

To satisfy the rule in section 1.401(a)(9)-1 of the proposed regulations, Q&A C-3(a), distributions must have begun by December 31 of the calendar year following the calendar year of Taxpayer A's death or by December 31, 1984. However, pursuant to section 1.401(a)(9)-1 of the proposed regulations, Q&A I-7, the initial distribution calendar year was delayed until 1985 and the required beginning date was December 31, 1987. To date, no distributions have been made from either Plan X or Plan Y. Thus, pursuant to section 1.401(a)(9)-1 of the proposed regulations, Q&A C-2, the five-year rule of section 401(a)(9)(B)(ii) of the Code applies. Pursuant to said five-year rule, distribution of Taxpayer A's entire interests in Plans X and Y must have been completed no later than the end of the calendar year which contains the fifth anniversary of Taxpayer A's death, or no later than December 31, 1988, the date required by section 1.401(a)(9)-1 of the proposed regulations, Q&A I-13.

Thus, with respect to your second and fourth ruling requests, we conclude as follows:

a. The minimum required distributions to the separate trust created under Taxpayer A's beneficiary designation dated October 20, 1978, for his benefits under Plan X and Plan Y are determined as follows:

(i) under Code section 401(a)(9)(B)(ii);

(ii) distribution of Taxpayer A's entire interest in both Plan X and Plan Y must have been completed by December 31, 1988;

(iii) the distribution period to be used in determining the amount of minimum required distribution for each calendar year is not the life expectancy of Taxpayer B for her attained age as of her birthday in the respective distribution calendar year;

(iv) recalculating the life expectancy of Taxpayer B is a moot issue; and

(v) the November 30, 1993 merger of Plan X into Plan Y does not change the Service's answers to (i) through (iv) above.

With respect to ruling requests (5) through (13), Code section 402(d)(1)(A) provides for the imposition of a separate tax (in the amount determined under subparagraph (B)) on a lump sum distribution.

Section 402(d)(1)(B) provides for the imposition of a tax in an amount equal to 5 times the tax which would be imposed by subsection (c) of section 1 if the recipient were an individual referred to in such subsection and the taxable income were an amount equal to 1/5 of the excess of-(i) the total taxable amount of the lump sum distribution for the taxable year, over (ii) the minimum distribution allowance.

Code section 402(d)(4)(A) defines a "lump sum distribution" as the distribution or payment within 1 taxable year of the recipient of the balance to the credit of the employee which becomes payable to the recipient-(i) on account of the employee's death, (ii) after the employee attains age 59 1/2, (iii) on account of the employee's separation from service, or (iv) after the employee has become disabled (within the meaning of section 72(m)(7)), from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501.

Generally, the "balance to the credit" for purposes of determining if a distribution is a "lump sum distribution" means all amounts standing to the credit of the employee under the distributing plan and payable because of the event giving rise to the distribution, i.e. separation from service or death.

Code section 402(d)(4)(B) provides, generally, that paragraph (1) shall apply to a lump sum distribution received on or after the date on which the employee has attained age 59 1/2 only if the taxpayer elects for the taxable year to have all such amounts received during such taxable year so treated.

Code section 402(d)(4)(B) further provides that in the case of a lump sum distribution made with respect to an employee to 2 or more trusts, the election under this subparagraph shall be made by the personal representative of the taxpayer.

Code section 402(d)(4)(C) provides, generally, that for purposes of determining the balance to the credit of an employee under subparagraph (A), all trusts which are part of a single plan shall be treated as a single trust, all pension plans maintained by the employer shall be treated as a single plan, all profit-sharing plans maintained by the employer shall be treated as a single plan, and all stock bonus plans maintained by the employer shall be treated as a single plan.

Code section 402(d)(4)(D) provides that, for purposes of Code section 402, the term "total taxable amount" means the amount of a lump sum distribution which exceeded the sum of-

(i) the amounts considered contributed to the employee (determined by applying section 72(f)), which employee contributions shall be reduced by any amounts theretofore distributed to him which were not included in gross income, and

(ii) the net unrealized appreciation attributable to that part of the distribution which consists of the securities of the employer corporation so distributed.

Code section 402(d)(3) provides that the total taxable amount of a lump sum distribution for any taxable year shall be allowed as a deduction from gross income for such taxable year, but only to the extent included in the taxpayer's gross income for such taxable year.

Code section 402(d)(2)(D) provides that in the case of a lump sum distribution with respect to any individual which is made only to 2 or more trusts, the tax imposed by paragraph (1)(A) shall be computed as if such distribution was made to a single trust, but the liability for such tax shall be apportioned among such trusts according to the relative amounts received by each.

Code section 402(d)(4)(F) provides that, for purposes of this subsection, no amount distributed to an employee from or under a plan may be treated as a lump sum distribution under subparagraph (A) unless the employee has been a participant in the plan for 5 or more taxable years before the taxable year in which such amounts are distributed.

With specific reference to distributions made to Taxpayer A's beneficiaries, section 1122(h)(3) of TRA'86 provides, with respect to lump sum distributions received by individuals who attained age 50 before January 1, 1986, that the tax imposed by section 1 of the Internal Revenue Code of 1986 on a taxpayer for a taxable year shall be equal to the sum of-

(i) the tax imposed by such section 1 on the taxable income of the taxpayer (reduced by the portion of such lump sum distribution to which clause (ii) applies, plus
(ii) 20 percent of the portion of such lump sum distribution to which the existing capital gains provisions continue to apply by reason of this paragraph.

Section 1122(h)(3) of TRA'86 further provides that not more than 1 election may be made under this paragraph with respect to an employee.

Section 1122(h)(6) of TRA'86 provides, in pertinent part, that, for purposes of paragraphs (3) and (4), the term "existing capital gains provisions" means the provisions of paragraph (2) of section 402(a) of the Code (as in effect on the day before the date of enactment of this Act).

Section 402(a)(2) (as in effect on the day before the date of enactment of TRA'86) provided that in the case of an employee trust described in section 401(a), which is exempt from tax under section 501(a), so much of the total taxable amount (as defined in subparagraph (D) of section 402(e)(4)) of a lump sum distribution as is equal to the product of such total taxable amount multiplied by a fraction-

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(A) the numerator of which is the number of calendar years of active participation by the employee in such plan before January 1, 1974, and

(B) the denominator of which is the number of calendar years of active participation by the employee in such plan. shall be treated as a gain from the sale or exchange of a capital asset held for more than six months. Section 402(a)(2) (as in effect on the day before the date of enactment of TRA'86) further provided that no distribution to any taxpayer other than an individual, estate or trust may be treated as a lump sum distribution under this paragraph.

Code section 402(e)(4)(D), in pertinent part, defined "total taxable amount" as the amount of a lump sum distribution which exceeded the sum of-

(i) the amounts considered contributed to the employee (determined by applying section 72(f)), which employee contributions shall be reduced by any amounts theretofore distributed to him which were not included in gross income, and

(ii) the net unrealized appreciation attributable to that part of the distribution which consists of the securities of the employer corporation so distributed.

Code section 402(e)(4)(L) provided, in general, that for purposes of subsection 402(a)(2), and subparagraph 402(e)(4)(E), a taxpayer may elect to treat the entire total taxable amount as ordinary income.

Section 1122(h)(5) of TRA'86 provides that an individual who has attained age 50 before January 1, 1986, and elects the application of section 402(e)(1) of the Internal Revenue Code of 1986 (as amended by this Act) (now Code section 402(d)(1)), may elect to have such section applied by substituting "10 times" for "5 times".

Section 402(e)(1)(A) (as in effect prior to the enactment of TRA'86) provided for the imposition of a separate tax on the ordinary income portion of a lump sum distribution.

Section 402(e)(1)(B) (as in effect prior to the enactment of TRA'86) provided that the amount of tax imposed by subparagraph (A) for any taxable year shall be an amount equal to the amount of the initial separate tax for such taxable year multiplied by a fraction, the numerator of which is the ordinary income portion of the lump sum distribution for the taxable year, and the denominator of which is the total taxable amount of such distribution for such year.

Section 402(e)(4)(E) (as in effect prior to the enactment of TRA'86) provided that, for purposes of section 402, the term "ordinary income portion" means, with respect to a lump sum distribution, so much of the total taxable amount of such distribution as is equal to the product of such total taxable amount multiplied by a fraction-

(A) the numerator of which is the number of calendar years of active participation by the employee in such plan after December 31, 1973, and

(B) the denominator of which is the number of calendar years of active participation by the employee in such plan.

Code section 402(e)(3) (as in effect prior to the enactment of TRA'86) provided that the ordinary income portion of a lump sum distribution for any taxable year shall be allowed as a deduction from gross income for such taxable year, but only to the extent included in the taxpayer's gross income for such taxable year.

Section 1.402(e)-2(d)(ii) of the Proposed Income Tax Regulations provides, in relevant part, that for purposes of computing the ordinary income portion of a lump sum distribution, the number of calendar months of active participation shall be the number of calendar months during the period beginning with the first month of plan participation and ending with the month of the plan participant's death.

Section 1.402(e)-2(d)(ii) of the proposed regulations further provides, in relevant part, that in computing the number of months of active participation, in the case of active participation before January 1, 1974, a part of a calendar year in which the employee was an active participant shall be counted as 12 months, and in the case of active participation after December 31, 1973, a part of a calendar month in which the employee was an active participant shall be counted as one month.

Revenue Ruling 83-121, 1983-2 C.B. 74, provides guidance regarding the tax treatment of lump sum distributions made to a trust. Initially, Rev. Rul. 83-121 provides that the part of a lump sum payment considered under Code section 402 to be either capital gain or ordinary income would be includible in the gross income of the trust.

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Rev. Rul. 83-121 further provides that such capital gain or ordinary income that is either used to determine the amount which is distributed or required to be distributed or is allocated to corpus and actually distributed would be included in determining the trust's distributable net income under Code section 643(a).

Additionally, Rev. Rul. 83-121 provides that if in the year of receipt by the trust, the trust is terminated and its principal, including capital gain and ordinary income, is distributed, then such amounts would be includible in computing distributable net income.

Rev. Rul. 83-121 also provides that if capital gain is includible in distributable net income and is distributed to the trust's beneficiaries, it retains its character as capital gain in the hands of the beneficiaries, and each beneficiary would report on his/her individual income tax return his/her proportionate share of the capital gain included in distributable net income.

Finally, Rev. Rul. 83-121 notes that a recipient of a lump sum distribution may elect to have the ordinary income portion of said distribution taxed under the ten year averaging rules of section 402(e) rather than as ordinary income.

Code section 661(a) provides that in any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust to which subpart B applies), the sum of-

(1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent that such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;
but such deduction shall not exceed the distributable net income of the estate or trust.

Code section 662(a) provides, generally, that, subject to subsection (b), there shall be included in the gross income of a beneficiary, to whom an amount specified in section 661(a) is paid, credited, or required to be distributed (by an estate or trust described in section 661), the sum of: (1) amounts required to be distributed

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currently whether distributed or not; and (2) all other amounts properly paid, credited or required to be distributed to such beneficiary. Code section 662(a) also contains language affecting income inclusion where amounts required to be distributed and/or amounts distributed exceed an estate's or trust's distributable net income for a taxable year.

Code section 662(b) provides that the amounts determined under subsection (a) shall have the same character in the hands of the beneficiary as in the hands of the estate or trust. For this purpose, generally, the amounts shall be treated as consisting of the same proportion of each class of items entering into the computation of distributable net income as the total of each class bears to the total distributable net income of the estate or trust.

With respect to ruling requests (5) through (13), Taxpayer A would have attained age 50 prior to January 1, 1986. Thus, a lump sum distribution from Plan Y (including a lump sum distribution from the portion of Plan Y which holds Plan X assets) is eligible for "grandfather" treatment in accordance with sections 1122(h)(3) and (5) of TRA'86.

Furthermore, Taxpayer A participated in Plan Y from July 1, 1967 to January 18, 1983. Thus, his period of pre-January 1, 1974 participation was 84 months, and his period of post December 31, 1973 participation was 109 months. His total period of participation was 193 months, and his pre-1974 participation consisted of 43.52 percent of the total, and his post-1973 participation consisted of 56.48 percent of the total.

Taxpayer A also participated in Plan X from July 1, 1971 to January 18, 1983. However, since Plan X was merged into Plan Y on November 30, 1993, his period of participation in Plan Y will also determine his period of participation in Plan X.

Additionally, pursuant to Code section 402(d)(2)(D), if a lump sum distribution with respect to Taxpayer A of all amounts standing to Taxpayer A in Plan Y (including amounts from the portion of Plan Y which holds Plan X assets) is made to the two trusts created under Taxpayer A's October 20, 1978 beneficiary designation, the tax imposed by paragraph (1)(A) shall be computed as if such distribution was made to a single trust, but the liability for such tax shall be apportioned among such trusts according to the relative amounts received by each.

With specific reference to the 10th ruling request, if an election is made pursuant to section 1122(h)(3) of TRA'86 to subject the capital gains portion of the lump sum distribution referenced above to the 20% capital gains rate, said capital gains portion would be subject to the distributable net income rules described in Rev. Rul. 83-121. Pursuant to Rev. Rul. 83-121, if such capital gains portion is actually distributed to the trusts's beneficiaries, in the year of receipt by the trust, it would be included in determining the trust's distributable net income under Code section 643(a).

With specific reference to the 11th ruling request, if an election is made such that the lump sum distribution is taxed in accordance with either the five-year averaging or the 10-year averaging method of taxation, the trusts referenced above will pay the tax on the portion of the lump sum distribution subject to averaging. The amount subject to averaging will then be deducted from the gross income of the trusts. The issue presented is whether said amount will be included in the distributable net income of the trusts in spite of the deduction.

We believe that the amount of the ordinary income portion of the lump sum distribution actually taxed in accordance with either the five-year averaging or the 10-year averaging method of taxation is included in determining the distributable net income of each trust. Such result is consistent with Rev. Rul. 83-121 because said amount(s) will constitute part of each trust's taxable income for the relevant year.

Thus, with respect to your ruling requests (5) through (13), we conclude as follows:

(5) A distribution by Plan Y to the separate trust created under Taxpayer A's October 20, 1978, beneficiary designation of the balance to the credit of the separate account maintained under Plan Y for Taxpayer A's benefits under Plan X that were transferred to Plan Y on November 30, 1993, and a distribution at the same time by Plan Y to the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation of the balance to the credit of the separate account maintained under Plan Y for Taxpayer A's benefits under Plan Y will:

(a) qualify to be treated as a lump sum distribution under Code section 402(d) as in effect for taxable years beginning before January 1, 2000;

(b) result in the gross distribution to the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation of his benefits under Plan X constituting the taxable amount to the trust:

(c) result in the gross distribution to the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation of his benefits under Plan Y, less the amount of the accumulated after-tax voluntary contributions which were made by Taxpayer A to Plan Y, constituting the taxable amount to the trust: and

(d) result in 43.52% of the taxable amount of the distributions to each of the separate trusts created under Taxpayer A's October 20, 1978 beneficiary designations being treated as the capital gains portion of the distributions and 56.48% being treated as the ordinary income portion.

(6) Since the distributions are being made by Plan Y to multiple trusts, the election under Code section 402(d)(4)(B) to treat the distribution(s) as a lump sum distribution must be made by the personal representative of Taxpayer A's estate;

(7) 43.52% of the taxable amount is eligible to be taxed at the 20% capital gains tax rate under paragraph (3) of section 1122(h) of the Tax Reform Act of 1986 (TRA'86), and the remaining 56.48% of the taxable amount is eligible to be taxed under either the 5-year averaging method of Code section 402(d) as in effect for taxable years beginning before January 1, 2000, or the 10-year averaging method of taxation under paragraph (5) of section 1122(h) of TRA'86;

(8) The tax under paragraph (3) of section 1122(h) of TRA'86 shall be computed as if such distribution(s) were made to a single distributee, but the liability for such tax shall be apportioned among Taxpayers C and D according to the taxable amount received by each taxpayer;

(9) The tax under the 5-year averaging method of taxation of Code section 402(d) as in effect for taxable years beginning before January 1, 2000, or the tax under the 10-year averaging method of taxation described in section 1122(h) of TRA'86, shall be computed as if such distribution(s) were made to a single trust, but the

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liability for such tax shall be apportioned among the two trusts according to the taxable amounts received by each trust;

(10) If the election to be taxed at the 20% capital gains rate under paragraph (3) of section 1122(h) of TRA'86 is made, then the capital gains portion will be included in determining the distributable net income of each trust;

(11) If each trust distributes equally to Taxpayer C and Taxpayer D the entire distribution it receives from Plan Y (including amounts transferred from Plan X) within the same taxable year of the trust in which it receives the distribution from Plan Y, then with respect to the capital gains portion of the distribution:

(a) the trust will be allowed a deduction for the amount of the capital gains portion under Code section 661(a) and, as a result, will not pay tax with respect to said portion;

(b) the capital gains portion will be taxed equally to Taxpayer C and Taxpayer D under Code section 662; and

(c) under Code section 662(b), the character of the capital gains portion will be passed through to Taxpayers C and D and they will be eligible to be taxed on said capital gains portion at the 20 percent capital gains rate pursuant to paragraph 3 of section 1122(h) of TRA'86.

(12) If the election under paragraph (5) of section 1122(h) of TRA'86 to be taxed under the 10-year averaging method of taxation or the election to be taxed under the 5-year averaging method of taxation described in Code section 402(d) is made, then the ordinary income portion will be included in determining the distributable net income of each trust;

(13) If each trust distributes equally to Taxpayer C and Taxpayer D the entire distribution it receives from Plan Y (including amounts transferred from Plan X) within the same taxable year of the trust in which it receives the distribution from Plan Y, then with respect to the ordinary income portion of the distribution:

(a) the trust will be allowed a deduction for the amount of the ordinary income portion under Code section 661(a) and, as a result, will not pay tax with respect to said portion;

(b) the ordinary income portion will be taxed equally to Taxpayer C and Taxpayer D under Code section 662; and

(c) under Code section 662(b), the character of the ordinary income portion will be passed through to Taxpayers C and D and they will be eligible to be taxed on said ordinary income portion under either the special 5-year averaging method under Code section 402(d) as in effect for taxable years beginning before January 1, 2000, or the special 10-year averaging method under paragraph 5 of section 1122(h) of TRA'86.

With respect to ruling requests 14 and 15, as noted previously, Taxpayer B intends to assign her limited right to trust income and principal to Taxpayers C and D. Furthermore, the trusts will be terminated and trust assets distributed to Taxpayers C and D.

The assignment, termination and distribution referenced above affect the amounts standing to Taxpayer A's credit in Plan Y (including amounts from the portion of Plan Y which holds Plan X assets) after such amounts have been distributed to the trusts. We do not believe that the assignment, termination and distribution should alter the tax consequences of Plan Y's distributing its assets to the trusts.

Thus, with respect to ruling requests 14 and 15, we conclude as follows:

(14) The assignment and transfer by Taxpayer B equally to Taxpayers C and D of any and all interest that she has in the separate trusts created under Taxpayer A's October 20, 1978 beneficiary designations does not affect the Service's answers to ruling requests (5) through (13) above;

(15) The termination and full distribution equally to Taxpayers C and D of the entire trust assets of the separate trusts created under Taxpayer A's October 20, 1978 beneficiary designations immediately after such trusts receive the distribution from Plan Y does not affect the Service's answers to ruling requests (5) through (13) above.

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With respect to ruling requests 16 and 17, Code section 401(a)(13)(A) provides, in pertinent part, that a trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that benefits provided under such plan may not be assigned or alienated.

Section 1.401(a)-13(c)(1)(ii) of the regulations defines "assignment or alienation" as "any direct or indirect arrangement whereby a party acquires from a participant or beneficiary" an interest enforceable against a plan to "all or any part of a plan benefit which is, or may become, payable to the participant or beneficiary".

With respect to your 16th and 17th ruling requests, Code section 401(a)(13) prohibits a plan participant or a beneficiary thereof from either alienating her plan benefits or assigning said plan benefits to a third party. In this case, because of the death of Taxpayer A, amounts held in Plan Y (including amounts from the portion of Plan Y which holds Plan X assets) for the benefit of Taxpayer A are payable to the trusts created under Taxpayer A's October 20, 1978 beneficiary designations. Your ruling request asserts that distributions from Plan Y (including distribution of amounts from the portion of Plan Y which holds Plan X assets) will be made to said trusts. Subsequent to these distributions, Taxpayer B, a limited income and principal beneficiary of the trusts, will transfer her interests in the assets of the trusts to Taxpayers C and D.

Taxpayer A's beneficiary designations require distributions from Plans X and Y be made to the trusts created under Taxpayer A's October 20, 1978 beneficiary designations. Thus, the proposal to make plan distributions to said trusts conforms with Taxpayer A's intentions.

Pursuant to Taxpayer A's October 20, 1978 beneficiary designations, Taxpayer B has limited rights to income and principal of the trusts which will receive distributions from Plans X (now held separately in Plan Y) and Y. Taxpayer B intends to assign said rights to Taxpayers C and D. Said assignment(s) assume that Taxpayer B has something to assign.

Taxpayer B's interests lie in trust and not plan assets. Taxpayer B only acquires said interests after distributions have been made to the trusts referenced in Taxpayer A's October 20, 1978 beneficiary designations. Once distributions have been made to the trusts, Taxpayer B, a beneficiary thereof, is free to dispose of her interests

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therein in any fashion she chooses without said disposition violating Code section 401(a)(13).

Furthermore, after distributions have been made from Plans X (now held separately in Plan Y) and Y to the trusts created under Taxpayer A's October 20, 1978 beneficiary designations, the trusts are free to dispose of their assets to their beneficiaries, including Taxpayers C and D, without said disposition violating Code section 401(a)(13). With further respect to the trusts's ability to dispose of their assets, since Taxpayer B may transfer her interests in the assets of the trusts to Taxpayers C and D without violating Code section 401(a)(13), the trusts may adhere to Taxpayer B's wishes and pay Taxpayers C and D amounts transferred to them by Taxpayer B without violating Code section 401(a)(13).

Thus, with respect to your 16th and 17th ruling requests, we conclude as follows:

(16) Each of the following will not be considered an assignment or alienation of benefits prohibited by Code section 401(a)(13);

a. A distribution by Plan Y to the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation of his benefits held in the separate account in Plan Y which account holds Taxpayer A's Plan X benefits transferred to Plan Y on November 30, 1993;

b. the assignment and transfer by Taxpayer B equally to Taxpayers C and D of any and all of her interest in the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation to receive his benefits under Plan X; and

c. the termination and full distribution equally to Taxpayers C and D of the entire trust assets of the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation to hold his benefits under Plan X immediately after such trust receives the distribution described in 16(a) above.

(17) Each of the following will not be considered an assignment or alienation of benefits prohibited by Code section 401(a)(13);

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a. A distribution by Plan Y to the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation of his benefits held in the separate account(s) in Plan Y which accounts hold Taxpayer A's Plan Y benefits;

b. the assignment and transfer by Taxpayer B equally to Taxpayers C and D of any and all of her interest in the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation to receive his benefits under Plan Y; and

c. the termination and full distribution equally to Taxpayers C and D of the entire trust assets of the separate trust created under Taxpayer A's October 20, 1978 beneficiary designation to receive his benefits under Plan Y immediately after such trust receives the distribution described in (17)a above.

With respect to ruling request 18, Code section 2501(a)(1) provides for the imposition of a tax on the transfer of property by gift.

Code section 2511(a) provides that the gift tax applies to a transfer by way of gift whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-1(e) of the Gift Tax Regulations provides that if a donor transfers by gift less than his entire interest in property, the gift tax is applicable to the interest transferred. The tax is applicable, for example, to the transfer of an undivided half interest in property, or to the transfer of a life estate when the grantor retains the remainder interest, or vice versa. However, if the donor's retained interest is not susceptible of measurement on the basis of generally accepted valuation principles, the gift tax is applicable to the entire value of the property subject to tax.

Section 25.2511-1(f) of the regulations provides that if a donor is the owner of only a limited interest in property, and transfers his entire interest, the interest in every case is to be valued by the rules set forth in

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sections 25.2512-1 through 25.2512-7. If the interest is a remainder or reversion or other future interest, it is to be valued on the basis of actuarial principles set forth in section 25.2512-5, or if it is not susceptible of valuation in that manner, in accordance with the principles set forth in section 25.2512-1.

Code section 2512(a) provides that, if a gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

Section 25.2512-1 of the regulations provides that the value of the property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts.

In this case, on January 18, 1983, the date of Taxpayer A's death, Taxpayer B, his surviving spouse, received a discretionary life interest in three accounts--

1. the Plan X benefits, and earnings thereon, payable to one trust;

2. the employer contributions account of Plan Y benefits, and earnings thereon, payable to a second trust; and

3. the employe contributions account of Plan Y benefits, and earnings thereon, payable to the second trust.

Taxpayer B may receive payments from these accounts, based on the ascertainable standard referenced above, only after she has consumed all of her other income.

As noted above, taxpayer B proposes to transfer her interest(s) in these accounts to her children, Taxpayers C and D.

In Lockard v. Commissioner, 166 F.2d 409 (1st Cir. 1948), donor/wife transferred property to a trust the terms of which provided her husband with income for life and so much of the principal, not to exceed $3,000 per year, as the trustee should determine in his uncontrolled discretion to be necessary for the comfortable maintenance and support of the husband. Upon the husband's death, the principal was to be paid to the wife or, if she predeceased her husband, to her executors, administrators or assigns. Based on the discretionary nature of the trustee's power to invade the principal and the limitations imposed on the power, donor valued the gift by subtracting the value of her retained reversion and basing the tax on the value of the life income interest.

The Commissioner redetermined the value of the gift to be the value "of the right of the beneficiary to receive each year the amount of $3,000 from the principal of the trust, together with the income of the diminishing trust fund, for the remainder of his life." 166 F.2d at 413.

The Court agreed with the Commissioner, stating--

> ...there was a gift of something more than a right to future income; there was also a gift of another intangible interest of a contingent nature, a right to receive payments out of principal, to a maximum of $3,000 per year in any calendar year, to the extent that the trustee should deem such payments necessary for the comfortable maintenance and support of the beneficiary. [Footnote omitted.] This interest, which will be protected by a court of equity, is certainly worth something, despite its contingent nature; in fact, the donee could hardly fail to regard its existence as a valuable assurance against future adversity, and it certainly is a property interest within the broad terms of the gift tax law.

166 F.2d at 413. See also McHugh v. United States, 142 F. Supp. 927 (Ct. Cl. 1956).

No facts with respect to the likelihood of an invasion of corpus, e.g., the donee's age at the date of the gift, his accustomed standard of living, or his other sources of income were presented by the taxpayer in Lockard. The Court held that there was no reliable actuarial method for computing the value of the donor's reserved right to receive the corpus back intact in case the trustee should not find it necessary to invade corpus.

Taxpayer B's life interests in the accounts at issue are similar to husband's interest in Lockard, and it is clear that these interests have some value, however minimal. For valuation purposes, an analogy can also be made to several estate tax charitable deduction cases.

In Ithaca Trust Co. v. United States, 279 U.S. 151 (1929), Merchants National Bank of Boston v. Commissioner, 320 U.S. 256 (1943), and Henslee v. Union Planters National

Bank & Trust Co., 335 U.S. 595 (1949), trusts were created wherein trustees were authorized to invade corpus for the benefit of the life income beneficiary under various circumstances, and the remainders were to pass to charity. The Supreme Court held that two requirements had to be satisfied in order to qualify the remainders for the charitable deduction: (1) the terms of the trust must limit the trustees' invasion power by definite and ascertainable fixed standards capable of being stated in terms of money and (2) the facts at the time of the transfer in trust must show the likelihood of invasion and the value of the power of invasion under the circumstances.

Revenue Ruling 54-538, 1954-2- C.B. 316, states that, in the case of a gift in trust with a retained interest, the amount required annually for a donor's support according to his accustomed mode of living may be ascertained and valued as an annuity.

Based on the above, we conclude that, Taxpayer B's discretionary life interests in Taxpayer A's Plan Y and Plan Y benefits have value. The invasion power of the trustees is limited by definite and ascertainable fixed standards, capable of being stated in terms of money. Taxpayer B will be considered as having made a gift for federal gift tax purposes on the date that she transfers these interests to her children, Taxpayers C and D. Based on the representations made concerning Taxpayer B's income and assets, which make the likelihood of invasion remote, we conclude that Taxpayer B's interests should be valued under the provisions of regulation section 25.2512-1. See O'Reilly v. Commissioner, 973 F.2d 1403 (8th Cir. 1992).

This ruling letter assumes that Plans X and Y either have been, are, or will be, qualified within the meaning of Code section 401(a) at all times relevant thereto. It also assumes that the trusts created under Taxpayer A's October 20, 1978 beneficiary designations are valid trusts under the laws of State F.

Pursuant to a power of attorney on file with the Internal Revenue Service, a copy of this letter ruling is being sent to your authorized representative.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

Enclosures:

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Form 437

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